CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 355

January 8, 1973

HORSE RACING CHARITY DAY RECEIPTS

Syllabus:

Revenue Ruling 72-542 has no application to California Horse Racing Corporations taxpayers due to the California statutory scheme and practice. Charity Days racing receipts are not income to the Racing Corporations and are thus excludable from gross income.

Advice has been requested on the subject matter in light of the recent Internal Revenue Service Revenue Ruling 72-542, and with particular reference as to whether a change in state taxing policy is in order.

Prior to the issuance of Revenue Ruling 72-542, neither the Internal Revenue Service nor the Franchise Tax Board had ever published a ruling on the subject of characterization of charity days racing receipts, but had issued individual letters to the taxpayers. Revenue Ruling 72-542 was issued in response to a request for advice which originated in a state other than California, and is not of universal application and is limited to its particular fact situation.

In the past California taxing policy has been to exclude charity days racing receipts from gross income. At the present time, and for several years immediately previous, the Internal Revenue Service has held charity days racing receipts includible in gross income and deductible as ordinary and necessary business expense. This policy has been consistently applied to all California taxpayers, and there appears to be no change in position contemplated by Internal Revenue Service in regard to California taxpayers at this time.

The California statutory scheme regarding horse racing charity days is contained in Section 19550 and following of the Business and Professions Code. By comparing the particular factual situation upon which Revenue Ruling 72-542 is based with the California statutory scheme, a variety of points of difference emerge under analysis. The Revenue Ruling refers to the election by the racing corporation to hold charity days; the money required to be passed on to charity came only from the pari-mutual wagers fund; the corporation in this instance formed the charitable foundation; the ruling was based on a voluntary transfer of property to the charitable organization.

This is contrasted with the California situation wherein the licensees are required to hold charity days as a condition of their license, the licensee is required to not retain for its own gain any portion of the proceeds of the charity days operations, the distributing agent is an independent and separate nonprofit organization, and there is nothing voluntary about the activities of the licensee. At no point do the licensees have a claim on any of the net receipts arising out of the charity days operations.

For income tax purposes, "income" is the gain derived from capital, from labor, or from both combined. Meyer v. Commissioner, 383 Fed.2d 883. It has been held that gross income does not include things received in the business transaction by a taxpayer who is not entitled to retain them. State v. Morgan Gin Co., 189 Southern 817. A taxpayer who is compelled by state authority to retain possession temporarily of funds was held not to have had "income" on that account for income tax purposes. Sohio Corporation v. Commissioner, 163 Fed.2d 590. If the taxpayer receives earnings under a claim of right and without restriction as to disposition, he has received income which he is required to report on his return. North American Oil Consolidated v. Burnet, 286 U.S. 417. Appeal of Mae M. Oury, Cal. St. Bd. of Equal., February 17, 1959, CCH 201-250, P-H 58, 151. Funds received without gain or benefit, with no freedom of disposition, and burdened with obligation to be paid over to others are not income. Decatur Water Supply Company v. Commissioner, 88 Fed.2d 341.

The taxpayer racing corporations have no claim of right to the charity days funds. They receive the funds with the considerable restriction that the funds be paid over to the distributing agent as soon as practicable after the determination thereof. The licensees are under legislative mandate to conduct the charity racing days. The statute specifically establishes that the purpose thereof is the distribution of net proceeds to the beneficiaries through the distributing agent. The licensees serve as conduit of the funds. Accordingly, it is held that the charity day proceeds do not constitute gross income to the California licensees.